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Remarks of David C. Vladeck[1]
Director, FTC Bureau of Consumer Protection
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Good morning. I want to thank the Promotion Marketing Association (PMA) for inviting me to speak at your Annual Marketing Law Conference. I appreciate having the opportunity to address so many of your members. I believe it is important to stay in touch with the people and organizations in industries that are affected by what the FTC does, and to foster transparency concerning some of our key initiatives. We may not always agree on approaches and outcomes. But our discussions help us understand each other, and provide insight into the challenges we each face and the goals we each have in doing our jobs.

This morning, you heard from FTC Commissioner Julie Brill. Commissioner Brill is a hard act to follow, but I hope you'll listen with some interest as I talk to you today about several additional areas in consumer protection where we have seen significant new developments or have had significant enforcement activity. These are: (1) the marketing of products and services using negative options; (2) new FTC order provisions regarding substantiation when making

[1] The views expressed here are my own and do not necessarily represent the views of the Federal Trade Commission or any Commissioner.

health claims; (3) marketing over mobile devices; and (4) the use of affiliate networks.

Negative Options

We have all purchased goods and services through a negative option. A negative option takes a consumer's silence as agreement to recurring charges, like a buying club or gym membership. Negative option agreements can benefit businesses and consumers. For businesses, automatic renewal reduces transaction costs. For consumers, it saves them from renewing subscriptions or memberships every month. Unfortunately, however, negative option offers also carry a high risk of consumer deception. Unscrupulous marketers often use negative option features to trap consumers in a cycle of recurring charges for goods or services they neither wanted nor knew they purchased. Today, I'd like to discuss some common negative option marketing abuses, and describe our recent law enforcement efforts targeting these abuses.

Negative option marketing abuses generally fall into three categories: (1) failing to adequately inform consumers of the negative option's terms; (2) advertising "free trials" that are so short they are essentially worthless; and (3) frustrating consumers' ability to cancel, either by not providing realistic cancellation procedures or by simply ignoring cancellation requests.

Inadequate disclosure can trap unwary consumers in a seemingly endless cycle of charges. Unscrupulous marketers have become expert in hiding disclosures where they are least likely to be noticed. They use mouse print, bury disclosures in complicated terms and conditions, provide disclosures at a point in the transaction when consumers are unlikely to read them, or make internet disclosures through hyperlinks that do not attract consumers' attention. In the most extreme cases, they fail to disclose the terms at all. As a result, consumers often have no idea that they signed up for a negative option plan.

Robust disclosure is even more important when sellers work in tandem to offer goods and

services in a single transaction, a process we refer to as "upselling." In an upsell, the first company markets its own goods or services, and then, after consumers provide their financial information, a second company offers a different product or service, often with a negative option. For example, a consumer buying a toy might receive a free trial offer for a children's magazine subscription before completing the transaction. If the consumer accepts, the first company often passes along billing information to the second. Without clear and conspicuous disclosures, consumers who have not provided payment information to the second company often have no idea they will be charged for the magazine subscription if they fail to cancel. Worse yet, consumers often do not discover these unexpected charges before being charged repeatedly, nor do they know how to cancel when they do.

Second, some marketers offer "free trial" periods so short that consumers cannot try the product or service before charges begin. Not long ago, the Commission addressed this problem in a case against Ultralife Fitness.[2] Ultralife lured consumers with a fourteen day "free trial" offer for diet pills, but in many instances the company began charging consumers before the free trial expired.

Finally, a negative option is not an option at all if consumers cannot easily cancel when they no longer want the goods or services. Dishonest marketers use a host of tricks to keep consumers on the hook. Some simply do not pick up the phone. Others put customers on hold for absurdly long times or fail to provide a working contact number. Even when consumers can make cancellation requests, dishonest marketers just ignore them.

When marketers engage in these fraudulent practices, we take action. In the past ten

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[2] *See* Press Release, "Internet Marketers of Dietary Supplement for Weight Loss Agree to Pay $150,000" (December 3, 2008), *available at* http://www.ftc.gov/opa/2008/12/ultralife.shtm.

years, the Commission has brought more than 60 cases against negative option marketers. I would like to highlight two recent cases involving some of the problems I just discussed.

In August of this year we sued Central Coast Nutraceuticals.[3] It offered "free trials" of dietary supplements. Once consumers signed up, Central Coast made it almost impossible to cancel. To avoid charges, consumers had to take several onerous steps within fourteen days of ordering. Central Coast buried these conditions in fine print on its websites and invoices. And even if consumers somehow did complete the steps, Central Coast often charged them anyway.

What's more, Central Coast, as part of its "free trial" offer, deceptively upsold negative options for other dietary supplements. The business's on-line order forms included pre-checked boxes indicating agreement to multiple recurring charges, but consumers did not see these purported agreements and never agreed to the charges.

Central Coast's scam cost consumers over 30 million dollars in 2009 alone. Considering the seriousness of its violations, we asked a United States District Court in Illinois to shut down the scheme, and the court issued a preliminary injunction doing just that. We are now seeking a permanent injunction and a return of the money Central Coast took from consumers.

Another case we filed this year involved a total lack of disclosure and a refusal to process cancellation requests. In that case, a company named Inc21 enrolled small businesses and individual consumers in a negative option plan without notice. Inc21 used offshore telemarketers who often told consumers that they would receive a free trial of a web advertising service, but that they would not have to cancel to avoid charges. In many other instances, the telemarketers would not even mention the negative option program and say the call was just to

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[3] *See* Press Release, "Court Orders Internet Marketers of Acai Berry Weight-Loss Pills and 'Colon Cleansers' to Stop Deceptive Advertising and Unfair Billing Practices" (August 16, 2010), *available at* http://www.ftc.gov/opa/2010/08/acaicolon.shtm.

verify business information like addresses and phone numbers. And in some instances, consumers would decline the negative option offers, and Inc21 would enroll them anyway. Because consumers never agreed to the services nor provided a credit card or bank account number, they did not expect to be charged. However, Inc21 added these undisclosed charges to the consumers' phone bills, ripping off millions of dollars from unsuspecting victims. Not surprisingly, a survey of Inc21's "customers" showed that at least 95 percent never even knew they were being billed.[4]

Even when Inc21's consumers were able to find out who was charging them and called to cancel, the company did not answer its phones. In fact, hearing the constant ringing of the company's phones, an employee asked one of Inc.21's owners why they were not answering. The owner explained "Oh, they're just customers who need assistance. We never answer those phones."[5] In that case, the court entered summary judgment against the defendants, requiring them to pay $38 million in consumer redress, among other things.

To those looking to deceive consumers, know that we are watching and will continue to enforce the FTC act vigilantly. In addition to shutting down scams and obtaining money for victims, we have a criminal liaison unit to refer the most egregious violators for prosecution. In one case, the fraudulent conduct was so egregious that the United States Attorney's Office in Cincinnati prosecuted the individual running the scam, seized his assets, and obtained a 25 year prison sentence against him.

To those marketers seeking to comply with the law, we advise you to adhere to three key

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[4] *FTC v. Inc21.com Corp.*, 10cv00022 (N.D. Ca. Sept. 21, 2010), Order on Cross-Motions for Summary Judgment at 2 (granting FTC's Motion for Summary Judgment and Denying Defendants' Motion for Summary Judgment).

[5] *Id*. at 21.

principles. First, clearly and conspicuously disclose the material terms of any negative option in a way that consumers will actually read and understand. Second, obtain consumers' express, informed consent before charging them. At a minimum, sellers should not misrepresent a negative option's terms, and consumers should have to take some action indicating their consent before incurring charges. Finally, provide a reasonable cancellation method and process cancellation requests in a reasonable amount of time.

As a last word on this topic, I would like to mention that we are reviewing our Rule on Pre-notification Negative Options, which imposes requirements on sellers who notify consumers that they will send merchandise unless the consumer objects within a certain time. Last year, the Commission sought comment on whether to expand the Rule to impose such requirements for all types of negative options. We received comments and will consider them in deciding whether to revise the Rule.

New Order Provisions in Ad Substantiation Cases

Let me turn now to another topic that may be of interest to PMA members – health claim substantiation requirements that are included in several recent FTC orders. These provisions appear in the settlement orders in the *Nestlé BOOST Kid Essentials* and *Iovate* cases,[6] as well as the notice order we recently issued with our complaint against POM Wonderful,[7] and the settlement order against POM Wonderful executive Mark Dreher.[8] Briefly stated, these orders

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[6] *See Nestlé HealthCare Nutrition, Inc.*, FTC File No. 092-3087 (consent order accepted for public comment); *FTC v. Iovate Health Sciences USA, Inc.*, No. 10-CV-587 (W.D.N.Y.) (2010) (Stipulated Final Order).

[7] *In re POM Wonderful LLC*, FTC Docket No. 9344 (filed Sept. 24, 2010).

[8] *In re Mark Dreher, Ph.D.*, FTC File No. 082-3122 (consent order).

require the companies, and in the case of Mr. Dreher, the individual, to comply with more specific and tailored substantiation requirements for certain types of health claims.

The new provisions serve two primary functions. First, they provide greater clarity to the companies and individuals who are required to comply with the orders. Second, they improve the enforceability of the orders. I'd also like to mention two things that the orders do not do. They do not represent a shift toward a stricter and more rigid substantiation standard. And, they do not represent a departure from existing policy as articulated in the FTC's Substantiation Policy Statement,[9] or from settled law – namely, the *Pfizer* case.[10] The Commission has not changed its fundamental approach to determining whether advertising claims are substantiated by competent and reliable scientific evidence in the first instance.

Let's look at the *Nestlé* case. In that case, the Commission investigated claims the company made for its "BOOST Kid Essentials" product, including that the product would reduce children's sick-day absences from school. Under the *Nestlé* order, the company may not claim that its BOOST Kid Essentials product will reduce sick-day absences, unless the claim is true and substantiated by at least two well-designed human clinical studies. This provision is based on expert opinion about the level of substantiation needed to support this particular claim for this particular product. The order provision does not represent a departure from *Pfizer* but is in fact an application of *Pfizer* to the claim at issue. What this provision effectively does is provide more transparency to the company as to what "competent and reliable scientific evidence" means for this claim, for this product, going forward. We think that is a good thing for everyone. Even

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[9] FTC Policy Statement on Advertising Substantiation, *appended to Thompson Medical Co.*, 104 F.T.C. 648, 839 (1984).

[10] *In the Matter of Pfizer, Inc.*, 81 F.T.C. 23, 64 (1972).

as far back as the 1980s and 1990s, the Commission imposed the requirement that, for particular claims, clinical trials would be needed for substantiation.

The *Nestlé*, *Iovate* and *Dreher* settlement orders, as well as the notice order in *POM Wonderful* – which sets forth the relief we are requesting in that litigation – also contain provisions prohibiting the respondents from making certain disease risk reduction claims without FDA pre-approval. This provision is included in the orders as fencing-in relief, because the FTC determined that the respondents had already made unfounded disease treatment or prevention claims – for example, the claim that Iovate's dietary supplements treat or prevent colds or flu. If the companies had made such unsubstantiated claims in labeling, the products would have been considered misbranded and therefore unlawful in interstate commerce under the Food Drug and Cosmetic Act. Extending that principle to other forms of advertising is not much of a leap and should not impose any additional substantiation burden on the companies under order.

I also want to emphasize that the requirement that certain disease and other health claims be approved by the FDA is consistent with long-standing Commission policy as set forth in our 1994 Food Advertising Policy Statement. Our 1994 Policy Statement made clear that the FTC generally expects unqualified health claims for foods and dietary supplements to be backed by "significant scientific agreement," which is the FDA's standard for the level of support required. Specifically, the Policy Statement says that the Commission regards this standard – which Congress itself set forth in the Nutrition Labeling and Education Act – "to be the principal guide to what experts in the field of diet-disease relationships would consider reasonable substantiation

for an unqualified claim."[11]

Finally, let me just say that even if a marketer is required by order to have FDA pre-approval for certain claims going forward, there is still some room for making qualified claims that would not be subject to that requirement. For example, the marketer could try to craft an advertising claim that characterizes limited scientific evidence supporting a relationship between a covered product and a particular disease. If the marketer can show – through reliable empirical testing – that the ad's net impression does not also convey the unqualified disease claim, then FDA approval would not be required. Now let me be clear: I believe that it is very difficult to adequately qualify a disease claim in this way. But if the marketer can show that consumers take away only the qualified claim, then the claim would be allowed, subject, of course, to other provisions in the order.

With consumers becoming increasingly health conscious, it is more and more common for consumers to want to find foods and dietary supplements that provide health benefits. Many companies are appropriately responding to this consumer demand by making large investments in research to develop products that can provide health benefits.

In this climate, I believe it is useful for businesses as well as consumers to have a clear understanding of how the Commission plans to use these new order provisions. We will use them on a case-by-case basis, depending on the nature of the challenged claims and what our experts tell us is appropriate substantiation for the claims at issue. We believe that these

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[11] *See* FTC Enforcement Policy Statement on Food Advertising, Section IV.A. *See also* Dietary Supplements: An Advertising Guide for Industry (FTC 2001), Section II.B., *available at* http://www.ftc.gov/bcp/edu/pubs/business/adv/bus09.shtm ("Where there is an existing standard for substantiation developed by a government agency or other authoritative body, the FTC accords great deference to that standard.").

provisions will facilitate order compliance by providing clearer guidance to companies about the precise level of substantiation required going forward, based on the type of health claim and the type of product at issue.

Mobile Marketing

I would like to turn now to another topic – that of mobile marketing. Protecting consumers in the mobile marketplace is one of the current challenges we face in the Bureau of Consumer Protection. According to a September report from the Pew Internet & American Life Project, cell phone ownership has risen dramatically in the U.S. over the past decade and now "82 % of American adults own a cell phone, Blackberry, iPhone or other device that is also a cell phone."[12] The Nielsen Company also tells us that more and more mobile subscribers are using smartphones (rather than feature phones) that allow users to access the web and email on the go and run a host of applications. Nielsen predicts that smartphones will overtake feature phones in the U.S. market in the third quarter of 2011.[13]

U.S. corporations are developing ways to use the mobile medium to reach consumers, whether it is to provide services or content, or to market their products. Just this month, one

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[12] Amanda Lenhart, "Cell phones and American adults," Pew Internet & Family Life Project, Pew Research Center (Sept. 2, 2010), *available at* http://pewinternet.org/Reports/2010/Cell-Phones-and-American-Adults/Overview/Findings.aspx.

[13] "Android Soars, but iPhone Still Most Desired as Smartphones Grab 25% of U.S. Mobile Market," Nielsen News, NielsonWire.com (Aug. 2, 2010), *available at* http://blog.nielsen.com/nielsenwire/online_mobile/android-soars-but-iphone-still-most-desired-as-smartphones-grab-25-of-u-s-mobile-market/.

company predicted that U.S. mobile advertising spending will reach 5 billion dollars by 2015.[14] Consumers can join texting programs that provide instantaneous product information and mobile coupons at the point of purchase. Consumers can search mobile websites to get detailed information about products, or compare prices on products they are about to purchase while standing in the retail aisle. Consumers can download mobile applications that perform a range of consumer services such as locating the nearest retail stores, managing shopping lists, tracking family budgets, or calculating tips or debts. They can also play interactive games containing targeted advertising. This market is exploding with new options for consumers and businesses.

The FTC has been actively addressing privacy issues relating to mobile technology for several years. In 2008, the Commission held a Town Hall meeting to explore the evolving mobile marketplace and its implications for consumer protection policy. Participants in the meeting examined topics such as consumers' ability to control mobile applications, and mobile commerce practices targeting children and teens. Because of the unique privacy issues raised regarding children, the Town Hall meeting led to an expedited regulatory review of the Children's Online Privacy Protection Rule. The review is taking place this year, even though it was originally set for 2015. In addition, our privacy roundtable discussions devoted a panel to addressing the privacy implications of mobile computing. This panel focused on two significant issues: the extent to which location-based services were proliferating in an environment without any basic rules or standards; and the degree to which transparency of information sharing

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[14] Leena Rao, "Smaato: U.S. Will Spend $5 Billion On Mobile Advertising In 2015," TechCrunch (Nov. 2, 2010), *available at* http://techcrunch.com/2010/11/02/smaato-u-s-will-spend-5-billion-on-mobile-advertising-in-2015/.

practices is possible on mobile devices. The Commission staff's upcoming report on the privacy roundtables will further address these issues.

As with any new medium, the FTC looks for potential concerns for consumers. New technology can bring tremendous benefits to consumers, but it also can bring new concerns and provide a platform for some of the old frauds to resurface. The mobile marketplace is no different. The FTC Act applies whether a company is marketing via the traditional telephone, the television, the desktop computer, or a mobile device. Certainly, there are some unique issues in this medium, like the small screen and the highly personal nature of the devices. These issues present some challenges as well as some opportunities for consumer protection. The important principle to remember, however, is that the same rules of the road apply for marketers in the mobile space as they do in the online and offline worlds. Marketing must not be deceptive or unfair. Marketers should not mislead consumers about what they are downloading on their mobile devices or treat them unfairly. Consumers should have clear information so they can make informed choices.

The FTC is ensuring that it has the tools necessary to respond to the growth of mobile commerce and conduct mobile-related investigations. In May of this year, the Bureau of Consumer Protection expanded its investigative resources to include a fleet of smartphone devices on various platforms and carriers. The staff also has obtained the equipment necessary to collect and preserve evidence from these mobile devices. With these additions, FTC staff has improved its ability to conduct research and investigations into a wide range of issues in the mobile space. I have also assembled a team of staff members to stay abreast of the new developments in mobile technology and watch for unfair and deceptive practices. This group is

conducting research, looking at apps, and following the latest reports on these technologies. We have some potential targets and I expect we will have some law enforcement actions coming.

As Commissioner Brill discussed earlier, the FTC has already brought a case this year applying FTC advertising law principles to the mobile application marketplace. In August, the Commission settled allegations that a marketing company, Reverb, deceptively endorsed gaming applications in the iTunes store.[15] The FTC alleged that the company posted positive reviews using account names that would give the readers the impression they had been submitted by disinterested consumers. The company agreed to an order prohibiting it from making such representations unless it discloses a material connection, when one exists, between the company and the product.

Finally, we have expanded our consumer education material on mobile use too. The latest update of our popular brochure "Net Cetera: Chatting with Kids About Being Online" includes information about using mobile phones. These materials encourage teens to think about their privacy and that of others before sharing photos and videos via cell phones. The materials also include information about texting and sexting, cell phone bullying, using cell phone location features, developing cell phone use rules within families, and more.

Affiliate Marketing

I also want to talk about our growing concern about online affiliate marketing. Marketing affiliates are third parties – often website operators or individuals – who drive traffic

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[15] *See* Press Release, "Public Relations Firm to Settle FTC Charges That It Advertised Clients' Gaming Apps through Misleading Online Endorsements" (August 26, 2010), *available at* http://www.ftc.gov/opa/2010/08/reverb.shtm.

to a seller's website in exchange for the payment of a commission from the seller. Affiliates can do this through several methods, including by sending mass emails, purchasing sponsored search engine results, or purchasing internet display ads. The biggest area of concern for the Commission regarding this type of marketing is that in some cases, affiliates are essentially let loose on the public without adequate direction or supervision to ensure that their advertising is truthful and non-misleading.

The affiliate marketing model often compensates affiliates on a "pay-per-click" or "pay-per-action" model where an affiliate's commission is calculated from the number of consumers it refers to the seller's site or how many consumers ultimately make a purchase. In many circumstances, affiliates have no or very few up-front costs. This structure gives affiliates an incentive to simply drive as much traffic as possible to the seller's website, by using any means that will achieve that goal. At times, those "means" include false and deceptive claims about the product, fake blogs, and other content that is not clearly identified as advertising or fails to disclose the material connection to the seller.

Affiliate marketing has become particularly prevalent for certain types of products, including teeth whitening and weight loss products. In addition to the deceptive practices employed to drive consumers to a seller's website, consumers who purchase products through these websites may be subjected to abusive negative option marketing practices such as hidden upsells, unauthorized charges, and inadequate cancellation procedures. We believe that legitimate marketers can and should play an important role in bringing more order and accountability to the affiliate marketing industry.

The Commission is doing its part too by bringing enforcement actions to stop deceptive

and unfair practices. We recently brought charges and obtained preliminary injunctions against several affiliate marketers who steered consumers to commercial websites that offered loan modification services.[16] The affiliates purchased sponsored search results at major search engines such as Google and Yahoo. When consumers searched for Making Home Affordable, the federal homeowner relief program offering free mortgage loan assistance, the search engines returned the sponsored results of the defendants, who made it appear that their advertisements were links to the federal government's official website, when in fact, they were not. Consumers who clicked on these sponsored results were instead directed to internet sites where they were prompted to enter personal identifying and confidential financial information. Their personal and confidential information was then sold to companies offering fee-based mortgage loan modification services. In this case, which we brought with assistance from the Special Inspector General of the Troubled Assets Relief Program (SIGTARP), affiliate marketing was used to take advantage of a particularly vulnerable and desperate population, homeowners in financial trouble who were seeking assistance from the federal government to save their homes.

We want to make sure that affiliate marketers are on notice that they will be held responsible for the claims they make. In addition, as with traditional forms of marketing, companies should understand that when they pay third parties to act on their behalf, they cannot absolve themselves of responsibility for whatever actions those third parties might take to sell the product. We urge anyone using affiliate marketing to be cognizant of the fact that FTC liability for deceptive advertising can potentially reach anyone in the chain between a seller and

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[16] *See* Press Release, Court Bars False Claims of Affiliation with United States Homeowner Relief Programs (July 10, 2009), available at http://www2.ftc.gov/opa/2009/07/homeafford.shtm

the ultimate consumer.

A case I talked about earlier, in the context of negative option marketing, also demonstrates this fact. In the Central Coast Nutraceuticals case, the defendant relied heavily on affiliates it hired to direct consumers to purchase its products by use of Internet advertisements, spam e-mails, pop-up advertisements, blogs, and other websites. The fact that it appeared that Central Coast's affiliates made the most outrageous product claims did not affect our action against Central Coast, especially in light of the facts suggesting that Central Coast knew exactly the kind of advertising it was getting from these affiliates.

We strongly encourage any company that chooses to use affiliates to market its products or services – either directly or through affiliate networks – to take some basic steps to ensure that the advertising messages being disseminated on your behalf are truthful. The first step is to give specific and detailed guidelines to the affiliates as to what information should be contained in any advertisements they disseminate. Equally important is guidance as to what reasonably foreseeable types of claims or language might be considered misleading and should *not* be used in ads. A second step is to do some quality control on the back end once consumers are directed to your website as a result of affiliate marketing. You should take a look at the affiliates and advertisements that are generating the largest numbers of referrals to see what types of claims the ads are making. And if you start to hear things from consumers that seem not quite right – if consumers are under the impression that you are part of the official federal government homeowner relief program and you're not, or whatever the case may be – then follow up and investigate to find out where these misconceptions are coming from, and take action to stop them.

We hope that businesses will become more aware of the potential problems they may encounter with affiliate marketing and proactively take steps to improve compliance in the industry.

I hope my speech today gives you greater insight into the initiatives and priorities of the FTC as we pursue our consumer protection mission in both emerging sectors of commerce and more traditional areas. As the nation's consumer protection agency, the FTC will remain vigilant in protecting consumers wherever and whenever the need arises.